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Memorandum

TO: BATA Authority

DATE: July 16, 2008

FR: Executive Director

RE: Resolution No. 81: Authorizing the Refunding of $2.4 billion Ambac Insured Variable Debt Portfolio

BATA Resolution No. 81 authorizes the actions necessary to refund the existing $2.4 billion Ambac insured variable rate debt portfolio. The Oversight Committee recommends that the Authority approve Resolution No.81.

Since December 2007, the financial world has been dealing with billions of dollars in losses related to the sub-prime mortgages. The losses have led to credit downgrades of most bond insurance guarantee companies including those used by BATA (XL Capital and Ambac). The first to lose its "AAA" status was XL Capital, now rated below investment grade. The Authority previously authorized the refunding of the $500 million XL Capital bonds, which was completed in early June. The refunding achieved its purpose by reducing the interest rate from 3.50% to 1.68% and saving over $10 million annually in potential interest costs.

BATA still has a $2.4 billion variable portfolio insured by Ambac. Our initial strategy was to preserve as much of the Ambac insurance as possible by converting the $510 million auction rate debt to Variable Rate Demand Option (VRDO) bonds and substituting new bank facility contracts for the existing $1.9 billion variable debt portfolio. Our strategy was based on Ambac improving its ratings and financial strength. Unfortunately, Ambac, has since lost its "AAA" ratings and is now rated in the "AA" category and negative watch by two rating agencies (Moody's and Standard & Poor's). The Fitch rating has been withdrawn at Ambac's request.

Since there is little prospect of Ambac restoring its "AAA" ratings anytime soon, we now propose to replace the Ambac insured bonds with uninsured bonds. The recommended process is as follows:

- Suspend the current Ambac insurance policies.

- Replace $1.7 billion of the $1.9 billion VRDO portfolio with uninsured VRDO bonds utilizing the new bank facility document developed by BATA and used to refund the XL Capital bonds.

- Refund the $510 million Auction Rate Bonds (ARB) portfolio as well as up to $200 million of the currently insured VRDO portfolio with uninsured fixed rate bonds.

- Modify the existing swap contracts for ARS and VRDO bonds converted to fixed rate bonds through a process of terminating, renegotiating or adding to the existing swap contracts in order to maintain the existing low interest rate levels.

The process of converting the $2.4 billion Ambac portfolio has already begun. Our bank agent at J.P. Morgan has secured sufficient uninsured liquidity capacity to convert $1.7 billion of the insured portfolio to uninsured VRDOs. The balance of $200 million along with the $500 million ARBs will be refunded as uninsured fixed rate bonds.

Since the existing swap contracts were written to cover variable rate bonds, they will have to be changed or terminated given the nature of the new fixed rate debt. The purpose of the swaps is to reduce overall interest costs which does not change even though the underlying debt changes from variable to fixed. BATA has several options available, such as converting or terminating the swaps, depending on which option proves to be cost effective and will maintain the purpose of lowering overall debt costs.

While most of the $2.4 billion Ambac insured portfolio will be reissued as uninsured bonds, we are not completely eliminating the insurance policy altogether. Ambac has agreed to "set aside" the current $2.4 billion policy, allowing BATA to re-issue the bonds on an uninsured basis. Ambac has offered two options to facilitate the transaction, a suspension of the policy for three years or issuance of a 3-year forward premium. The options can be used by BATA anytime over the next three years at no cost to BATA. In addition, the reserve surety and swap policies will continue to remain in effect during the Ambac policy suspension period.

Resolution No. 81 authorizes the steps necessary to complete the conversion of up to $2.4 billion in Ambac insured bonds to uninsured bonds. The resolution authorizes:

- Issuance of up to $800 million in Ambac insured refunding bonds consisting of $510 million ARS, $200 million in currently insured VRDO bonds plus debt service reserves and costs of issuance.

- Purchase of Ambac insured bonds prior to refunding.

- Amending, restructuring or terminating existing swap agreements and entering new agreements to hedge the new fixed debt.

- Entering into agreements with Ambac providing for Ambac to suspend the existing policies.

- Entering into new liquidity agreements.

- Not-to-exceed rates:
  - Fixed rate 6.00%
  - Variable rate 12.00%
  - Cost of Issuance 1.50%

		$800 Million
Underwriter's Discount	1.0%	$8.0 million
Cost of Issuance:	.50%	$4.0 million
▪ Bond Counsel		
▪ Financial Advisor		
▪ Rating Agencies		
▪ Disclosure Counsel		
▪ Trustee		
▪ Printing		
Total	1.50%	$12.0 million

- Debt service coverage not-less-than 1.50x maximum annual debt service.

The interest rate cap on the new fixed rate historically set at 5.25% has been increased to 6.00% to reflect the rising interest rate market.

The recommended actions should represent the final steps required to correct the insured debt portfolio. While the process has been difficult, we have had some success restoring prior interest rate levels, preserving low cost swaps and preserving the bulk of the insurance policies.

The Oversight Committee recommends the Authority approve Resolution No. 81. The Committee also requested that staff provide the full Authority with additional information relative to the additional issuance costs associated with our recent refinancing transactions. We will provide this information at your meeting next week.

In addition, staff now believes that the entire $800 million in debt capacity authorized by this action will be needed for the Ambac refunding in light of current liquidity constraints. We had previously informed the Committee that up to $200 million in capacity might be available for new project funds. This change is reflected in the attached version of Resolution No. 81 in redline/strikeout format.

Steve Heminger

SH/BM/cj

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